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SME Internationalization Processes in a Transitioning Entrepreneurial Economy

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Abstract

Researchers need to re-conceptualize their thinking on the internationalization process of smaller firms (Bell, et al 2003). It is therefore the purpose of this study to generate a theoretical contribution to the growing field of International entrepreneurship with a specific focus on the *process* of internationalization of Small and Medium Enterprises (SMEs). The investigation involved a multi-level analysis of SME internationalization, tracing the transition process of the individual entrepreneur to a domestic enterprise thru to an international SME. Using the combined theoretical lenses provided by constructs such as Competitive advantage, Networks and Psychic Distance, this study addressed the observed gap in terms of exploratory, in-depth analysis of SME internationalization. Adopting a case study approach, it aims to contribute to a richer, more in-depth understanding of the cross-border operations of SMEs. The research also has practical value as SMEs can draw from this body of knowledge as they pursue opportunities internationally.

Introduction

The latter part of the 20th century exhibited an interesting reversal of the dominant force in the world economy. Whereas the first three quarters of the century was characterised as a managed economy, dominated by larger, bureaucratic organisations (Audretsch & Thurik, 2001), the last two decades and the early 21st century saw the emergence of Small and Medium Enterprises (SMEs). There is a range of explanations provided for the occurrence of this phenomenon. Joseph Schumpeter (1934, 1942) wrote about the process of *creative destruction* – involving the constant creation of new ideas by innovative firms that, in turn, disestablishes the positions of stagnant, non-innovating firms. The early 1990s saw the world economy affected by global events such as the twin oil crisis and an observed increase in the self-employment rate (Acs and Audretsch, 1993). These events had a particular impact on the operations of the large firm, but at the same time was also pulling in small entrepreneurial firms from their marginalised economic positions to one where they are recognised as a participant in the overall economic development effort.

In 1994, John Naisbitt, author of such bestsellers as *Megatrends* and *The Global Paradox*, wrote about the potential economic power of entrepreneurial ventures including SMEs, to quote “The bigger and more open the world economy becomes, the more small and middle-sized companies will dominate.” Naisbitt, like many others, have attempted to explain the rise of SMEs with developments like computers and telecommunications, deregulation and globalization of financial market, reduced trade barriers all over the world, converging consumer tastes, ease and facility of “replicating” quality and small firm flexibility in terms of labour force.(source: Naisbitt, 1994, p12-20).

Audretsch and Thurik (2001) argue that the emergence of the entrepreneurial economy is a response to two fundamental aspects of globalisation, i.e., the emergence of low-cost but highly-skilled competitors in Central and Eastern Europe, as well as in Asia; and the telecommunications and microprocessor revolution, that substantially facilitates the shifting

of standardised economic activity out of high-cost locations. Undoubtedly, SMEs have risen to prominence, and this further supports what Audretsch and Thurik (2001) refer to as a “fundamental shift from a managed economy to an entrepreneurial economy.” The two economic structures are contrastingly different – the former characterised by stability, continuity and homogeneity, while turbulence, diversity and heterogeneity are central to the latter. SMEs now constitute a dominant sector in the world economy, accounting for over 95% and up to 99% of the business firms population. In 2003, 99.8% of enterprises in the enlarged EU were SMEs. Firms in this category, bringing with them the entrepreneurial qualities of innovation, risk-taking and pro-activeness have now gained world-wide recognition as a key source of dynamism and flexibility in advanced industrialised countries, as well as in emerging and developing economies. The SME sector has contributed significantly in terms of net job creation in OECD countries, consequently making the important inputs towards innovation, productivity and economic growth (OECD, 2005).

Implicit in the increasing importance and visibility of SMEs is the observed increase in the involvement of firms in this category in international business. There is strong evidence that international growth and expansion is a major priority of firms around the world. The explosion of international growth is reflected in the rise of Foreign Direct Investment (FDI) or alternative types of investments in overseas markets that involve managerial control of a production or service enterprise. This international growth is indicated both in the monetary value of transactions and the number companies with international operations. From around US\$60 billion of new investment in 1985, this topped US\$800 billion by 1998 (United Nations, 2000) and this burgeoning trend has continued well into the 21st century.

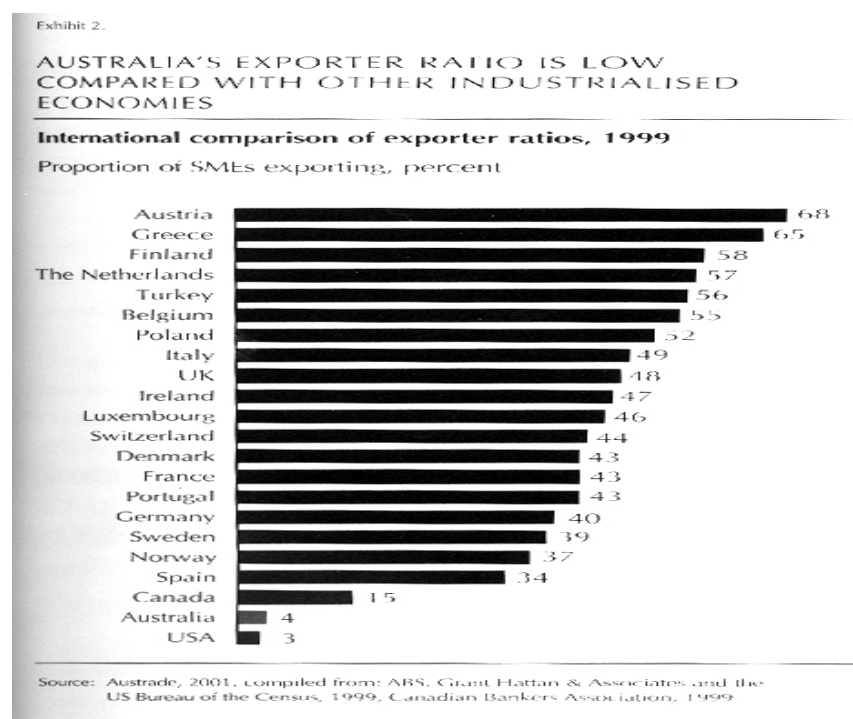
Though the growth of SMEs is now considered as crucial to a nation’s economic development and well-being (Coviello & Munro, 1995; OECD, 2003), this development is not always a matter of choice by the individual firm. The drivers of globalization are continuously dismantling the barriers, geographic or otherwise, which segmented the competitive environment of domestic and international firms. Firms of all sizes now share a common competitive space (Etemad, 1999; Dana, et al. 2000 and 2001). As a consequence, it is increasingly difficult for independent SMEs to survive unless they become internationally competitive – whether or not they operate in international markets (Etemad, 2003). Domestic markets are becoming integral parts of a broader, global whole. It is therefore apparent for SMEs that competing globally is not a mere option, but an economic imperative. This trend is not only expected to create a radically altered competitive environment for all economies (Rutashobya & Jaensson, 2004) but also has implications on the process of internationalization that SMEs undergo.

Australia SME’s low participation rates in international trade

Australia, however, presents a contradiction to indicative trends around the world. It is a wealthy, developed resource-rich nation with few large indigenous multinationals. The resulting limited scale of outward FDI contrasts sharply with Australia’s long-term dependence on foreign firms and technology (Maitland & Nicholas, 2002). Estimates from the Australian Bureau of Statistics indicate that about 25,000 businesses across Australia exported in 2000/01 – a mere 4% of all businesses in the country. Although the proportion varies among different firm size categories (Small: 3%; Medium 13%, Large: 32%; and SMEs: 4%), amongst SMEs this proportion is well below that of most European countries and Canada, but comparable with the USA (AUSTRADE, 2001). More recent data from the Australian Trade

Commission, however, indicate that Australian SME participation rates in international trade are growing. According to the May 2001 Yellow Pages Business Index, 21% of Australian SMEs are involved in international business activities (Harcourt, 2001). It must be understood, though, that this performance still fades in comparison to what other industrialised nations have experienced. This is apparent in the Australian Trade Commission (2001) data shown in Figure 1 below. The indication is that for most of the industrialised economies accounted for in the data, more than a third of the total SMEs (ranging from 34% - Spain to 68% - Austria) are involved in export trade. These empirical observations indicate that Australian SMEs face significant challenges in going international.

FIGURE 1: Australia SMEs' participation rates in international trade



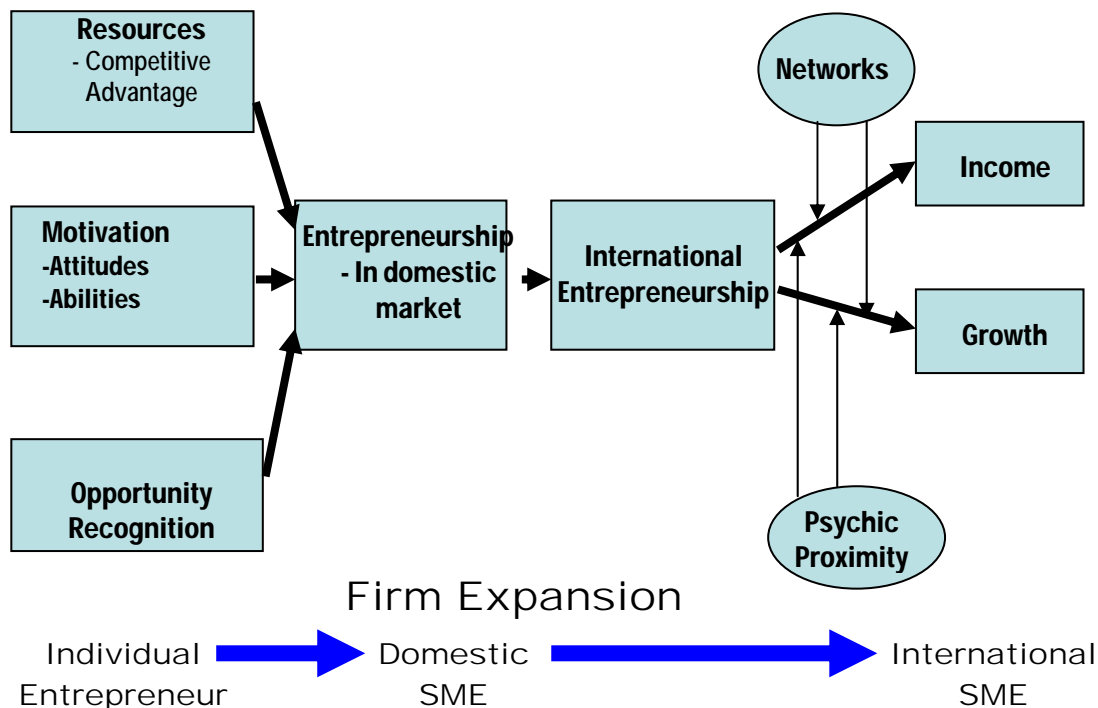
For economies like Australia, one of the most important implications of globalization is that comparative advantage shifts away from traditional factors of production like land, labour and capital to knowledge-based resources. Consequently, it will be the ability to create, access and commercialize knowledge on a global context that will form the basis of the SME's competitiveness. This fundamental shift has necessitated some significant structural changes in the Australian economy during the last 15 years. Being an open and flexible economy, integrated into the key global markets of Asia, America and Europe, Australia has kept up with global trends. Combined with the growing convergence of markets around the world, economic reform measures such as lower tariffs, financial de-regulation, labour market and tax reforms has led to this integration. In turn, these have created increased demands and challenges for Australian firms (Alam & Pacher, 2003). In September 2001, the Australian Productivity Commission conducted a survey of 201 Australian firms. The survey builds on a smaller survey undertaken in 1995 by the Industry Commission for its public inquiry on the *Implications for Australia of Firms Locating Offshore* (IC 1996). Though there is evidence of the FDI expansion by Australian firms, Australia remains a relatively small player in the international investment community – accounting for around 0.6 and 0.4 per cent of global FDI inflows and outflows, respectively, in 1999. This is well below Australia's contribution to global income, which was around 1.3 per cent in 1999 (World Bank 2001). Australia's

observed ‘insularity’ has retarded its involvement in global markets with most firms still anchored on domestic markets. Australian companies have shown indications of internationalization but limited to a multi-domestic strategy with small, fragmented overseas operations (BRW, 25 September 2000).

Focus of the Study

This study is about International Entrepreneurship – a field that draws from the broader, more established disciplines of International Business and Entrepreneurship (Zahra & George, 2002). Despite the increasing interest in the various dimensions of International Entrepreneurship, the studies that have been done on Australian SMEs in recent years indicate that there remains the need to conduct exploratory, in-depth analysis to generate qualitative insights that will shed light on the observed limited involvement of Australian SMEs in international markets. The gap in the understanding of these unique, firm-specific processes, which reflects the interrelationships between internal and external drivers of internationalization, is more pronounced in an economy like Australia, which is seen to be shifting towards an entrepreneurial economy. Alam and Pacher’s (2003) examination of the challenges facing internationalizing Australian firms asserts that there is a notable new emphasis on entrepreneurship. Following on from Zahra and George’s (2002) definition of international entrepreneurship - *“the process of creatively discovering and exploiting opportunities that lie outside a firm’s domestic markets in the pursuit of competitive advantage.”*, and considering the identified gaps in the investigation of this phenomenon, there is potential for making a theoretical contribution by examining international entrepreneurship in the context of constructs such as the Resource-Based View, Entrepreneurial motivations and behaviour, Opportunity Recognition, Network theory, and Psychic proximity.

Figure 2: Conceptual Framework for Study



As suggested earlier, the aim of this study is to examine the interplay between the above cited constructs. It is important to investigate this interplay from a holistic perspective as firms do not make isolated decisions in the process of internationalization. Ultimately, it is hoped that the study will provide a better understanding of the process through which domestically operating SMEs can expand their activities to international markets. Given this background, the study attempts to address the following **research question:**

What are the drivers of internationalization for Australian SMEs?

A review of the extant literature indicates the following research issues:

- RI 1** What organisational resources will have a significant impact for the development of a Sustainable Competitive Advantage (SCA) for Australian SMEs in international markets?*
- RI 2** How can Australian entrepreneurial ventures improve their internationalization process and hence increase the probability of success of their entry into foreign markets?*
- RI 3** Is psychic proximity a significant mediating factor for Australian SMEs as they venture into overseas markets?*
- RI 4** How can Australian SMEs utilize networking and industry clustering as an effective approach for internationalization?*

Research Approach and Methodology

The research aims to investigate the SME internationalization process in a holistic manner and to understand the complex web of interrelated decisions leading to the internationalization of an SME. To address this gap in knowledge, it was important to conduct a thorough and in-depth examination of four Australian SMEs in the technology sector. Adopting a case study approach, the in-depth examination involved open-ended questions for owner/managers within each case study firm. This approach was chosen in order to understand the complexity of a single case - to clarify its particularity (Stake, 1995). In addition, reviews of available historical/archival data and cross-checking/validation with other interviewees within each case organisation was conducted. This iterative process that drew from several sources of information, was done in order to corroborate initial data collected and/or identify any disconfirming evidence. By doing so, a richer understanding of the “drivers” of internationalization was achieved.

Main Findings from the Study

The conduct of this investigation represents an important step towards achieving a re-conceptualisation of the internationalization process of SMEs – a gap that has been identified by several authors who have published in the international entrepreneurship area. It was found that the owner/managers interviewed had considerable overseas exposure and saw the Australian market as limited. Consequently, the respondents had decided at firm inception or at a very early stage of their operations that they would pursue opportunities in international markets. The study further revealed that four SMEs who were part of this study have based their success in international markets primarily on **(1)** an innovative product that conforms to global quality and competitive standards; and **(2)** a visceral connection with well-defined niche markets. In addition, the investigations drawing from multiple data sources, indicate that these firms have combined the following elements to achieve continued international success:

- Leveraging on information technology
- Personal contacts and earning the trust of current and potential clients
- Planned, systematic approach to their internationalization
- Customer responsiveness and appropriate Customer Relationship Management systems
- Availing of training for international operations and other forms of government assistance

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